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DE RUEHMO #2735/01 3100600
ZNY CCCCC ZZH
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FM AMEMBASSY MOSCOW
TO RUEHC/SECSTATE WASHDC PRIORITY 5317
INFO RUCNCIS/CIS COLLECTIVE PRIORITY
RUEHXI/LABOR COLLECTIVE PRIORITY
RUEHJD/MOSCOW POLITICAL COLLECTIVE PRIORITY
RHEHNSC/NSC WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002735

SIPDIS

STATE FOR EUR/RUS, DRL
DOL FOR BRUMFIELD

E.O. 12958: DECL: 11/05/2019
TAGS: ECON FIND ELAB PGOV RS SOCI
SUBJECT: GOR CONTINUES STOP-GAP BUSINESS MODEL

REF: A. ST.PETERSBURG 68
1B. ST.PETERSBURG 116

Classified By: EconMinCouns Matthias J. Mitman, Reasons 1.4 (b,d)

SUMMARY

11. (C) Recent interventions in Pikalevo and Tolyatti demonstrated the GOR's commitment to preventing social unrest but also highlighted its failure to address the underlying problems facing Russian industry. After the enterprises of the Pikalevo production chain were unable to reach a new production agreement by the end of October, Deputy Prime Minister Sechin set a deadline of November 16 for them to solve their differences. Separately, Prime Minister Putin announced this week that the GOR would provide 38 billion rubles (USD 1.3 billion) in debt restructuring to nearly bankrupt auto manufacturer AvtoVaz. However, experts assert that the GOR lacks the initiative to complete fundamental reforms necessary to strengthen its domestic economy. Recent measures taken to shore up the Pikalevo production chain and AvtoVaz reflect a GOR strategy of spending whatever is necessary to maintain order while waiting for the overall economy to turn around. The GOR's ability to postpone dealing with deeper structural problems will depend on how quickly the economy rebounds in the months ahead. End Summary.

SHORT-TERM AGREEMENTS WITHOUT LONG-TERM SOLUTIONS

12. (SBU) Whether by providing debt restructuring assistance to AvtoVaz in Tolyatti or intervening in pricing and production disputes among enterprises in Pikalevo, the GOR continues its pattern of interjecting itself into situations in which corporations' financial problems threaten to aggravate social tensions. The collapse of the construction sector last fall brought to light issues concerning the long-term viability of cement and mineral production enterprises in the town of Pikalevo. Prime Minister Putin berated Oleg Deripaska and the other owners of the production chain on national television before forcing them to sign a three-month agreement that would restart production (see reftel A). The companies were unable to reach an agreement on the price of materials, and the Federal Anti-Monopoly Service intervened to determine price levels acceptable for all players involved, which facilitated the conclusion of an additional agreement regulating production and prices through the end of October (see reftel B). Disputes over prices, payment, and production methods continued among the members of the chain. On October 28, Deputy Prime Minister Igor Sechin met with the parties involved with the goal of

reaching a new joint production agreement, without which production could again halt in November. Sechin laid down a deadline of November 16, by which time he expects the companies to conclude an agreement.

¶3. (C) Similarly, Prime Minister Putin announced in November that the GOR would interpose itself between AvtoVaz and its creditors to help the company stave off bankruptcy. While the relief package will include cash injections to revive AvtoVaz' model line-up and create new jobs, the vast majority of assistance will take the form of 38 billion (USD 1.3 billion) rubles in government issued bonds. AvtoVaz' creditors, primarily state-owned Sberbank and VTB, will be able to exchange AvtoVaz debts for lower risk government bonds. According to press reports, AvtoVaz' debts will exceed 76 billion rubles (USD 2.6 billion) by the end of the year, not counting 9.7 billion rubles (USD 330 million) owed to its suppliers. Last month, Deputy Prime Minister Shuvalov also announced that regional and municipal authorities in Samarskaya oblast would assume responsibility for the financing of AvtoVaz' social infrastructure, which would total approximately 1.8 billion rubles (USD 61 million) per year. Company and government officials have not yet made clear how this new round of state assistance will affect AvtoVaz' previously announced plans to reduce the size of its workforce by more than 27,000 workers. Shuvalov was quoted as stating that AvtoVaz would inevitably have to shed 21,000 jobs to operate efficiently. The real problem the GOR is beginning to realize is that it has assumed the burden of paying AvtoVaz' debts to state-owned banks without imposing conditions on company management or insisting on operational reforms. Only recently - and late in the game - was there

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discussion of attracting "strategic investors" to implement a broader development plan to revive AvtoVaz.

¶4. (C) Despite its obvious commitment to preventing social unrest in economically depressed regions, the GOR has not demonstrated the willingness to undertake on its own the reforms necessary to facilitate the long-term growth and sustainability of the Russian economy. During our last meeting, All-Russian Confederation of Labor President Boris Kravchenko complained that the GOR had wasted eight years of economic growth by failing to address the country's economic problems, paving the way for the precarious situation in which many workers in the ailing industrial sector now find themselves. In the case of Pikalevo, Alexander Shitov, Chamber of Trade and Industry Deputy Chairman, told us this week he was certain Sechin would succeed in mediating a new production agreement among companies, and that the GOR would facilitate whatever financing the companies needed to save workers' jobs. On the other hand, Shitov confidently stated that the GOR and Russian businesses would not voluntarily take the steps necessary, either in terms of an improved investment climate and stronger rule of law or in terms of industrial innovation and diversification, to ensure their profitability and competitiveness. According to Shitov, Russia needs WTO membership and the associated institutional regulations and pressure of trade liberalization to provide the impetus to develop and diversify its economy.

COMMENT

¶5. (C) Russian efforts to resolve production disputes or prevent downsizing in major corporations consistently emphasize short-term measures to save jobs over the fundamental reforms needed to transform aging industrial giants into viable enterprises. Falling domestic demand and declining industrial output and construction brought on by the financial crisis have highlighted the weakness and inefficiency of many major corporations. While the GOR is committed to doing whatever it takes to prevent the crisis from fomenting social unrest, it is unwilling to undertake

the deeper legal and institutional reforms needed to attract investment, modernize Russian industry, and diversify the economy. Recent GOR decisions reflect a belief that the government and Russian businesses can avoid these reforms by holding out until the economy turns around. This strategy is not without risks, especially if Russia's economic recovery - dependent as it is on world commodity prices and global economic growth - does not accelerate quickly next year. End Comment.

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